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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of

1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers	)	CC Docket No. 98-137
Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, *et. al.*	)	CC Docket No. 99-~~177~~ 117
GTE Telephone Operating Companies Release of Information Obtained During Joint Audit	)	AAD File No. 98-26

COMMENTS

of the

GENERAL SERVICES ADMINISTRATION

GEORGE N. BARCLAY
Associate General Counsel
Personal Property Division

MICHAEL J. ETTNER
Senior Assistant General Counsel
Personal Property Division

GENERAL SERVICES ADMINISTRATION
1800 F Street, N.W., Room 4002
Washington, D.C. 20405
(202) 501–1156

Economic Consultants:
Snavely King Majoros O'Connor & Lee, Inc.
1220 L Street, N.W., Suite 410
Washington, D.C. 20005

April 17, 2000

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SUMMARY

GSA recommends that the Commission reject the alternative waiver procedure recommended by CALLS.

The CALLS proposal would allow the ILECs to amortize the difference between their regulatory book and financial book depreciation reserves on an above-the-line basis over the next five years. This would allow the ILECs to report rates of return similar to that which would result from the use of the much shorter depreciation lives which the Commission has repeatedly, and very recently, rejected.

The CALLS proposal would also significantly limit the information available to the Commission for use in establishing projection life and future net salvage percent ranges. The Commission's depreciation ranges are critical to the determination of inputs for cost models used in establishing high cost support, interconnection and unbundled network element prices. If it is to remain well-informed, the Commission must establish appropriate reporting requirements for all ILECs.

Finally, the Commission should proceed with its CPR audit proceeding regardless of the outcome of the instant proceeding. The CPR audits indicate that ILEC gross plant investment is overstated on both their regulatory and financial books. The Commission must ensure that this situation is corrected.

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COMMENTS
of the
GENERAL SERVICES ADMINISTRATION

The General Services Administration ("GSA") submits these Comments on behalf of the customer interests of all Federal Executive Agencies ("FEAs") in response to the Commission's Further Notice of Proposed Rulemaking ("Notice") released on April 3, 2000. In the Notice, the Commission seeks comments and replies on the conditions under which its existing depreciation rules may be eliminated or changed for all price cap carriers.

I. INTRODUCTION

Pursuant to Section 201(a)(4) of the Federal Property and Administrative Services Act of 1949, as amended, 40 U.S.C. 481(a)(4), GSA is vested with the responsibility to represent the customer interests of the FEAs before Federal and state regulatory agencies. The FEAs require a wide array of interexchange and local telecommunications services throughout the nation. From their perspective as end users, the FEAs have consistently supported the Commission's efforts to bring the benefits of competitive markets to consumers of all telecommunications services.

Until such time as competition provides an effective control over incumbent local exchange carrier ("ILEC") prices, however, the Commission must continue to maintain rules which assure just and reasonable rates. GSA shares the Commission's concern that any changes in depreciation practices do not adversely impact consumers and competition.[1]

The Commission's Depreciation Order set forth specific conditions under which price cap ILECs may seek a waiver of the Commission's depreciation requirements.[2] The Notice summarizes these requirements as follows:

> Specificially, we found that a waiver may be appropriate when an ILEC voluntarily, in conjunction with its request for waiver: (1) adjusts the net book costs on its regulatory books to the level currently reflected in its financial books by a below-the-line write-off; (2) uses the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) foregoes the opportunity to seek recovery of the write-off through a low-end adjustment, an exogenous adjustment, or an above-cap filing; and (4) agrees to submit

[1] Notice, para. 3.

[2] 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket No. 98-137, Report and Order, FCC 99-397, released December 30, 1999 ("Depreciation Order").

> information concerning its depreciable plant accounts, including forecast additions and retirements for major network accounts and replacement plans for digital central offices. We also stated that waiver requests must comply with the waiver requirements under the Commission's rules.[3]

The Commission has initiated the instant proceeding in response to a March 3, 2000 letter by the ILEC members of the Coalition for Affordable Local and Long Distance Service ("CALLS").[4] In conjunction with the CALLS proposal for universal service and interstate access reform, the ILECs propose an alternative depreciation waiver procedure. The Notice summarizes the ILEC proposal as follows:

> Specifically, the letter outlines steps that the ILECs propose to take to achieve freedom from depreciation requirements, including: (1) use of the same depreciation factors and rates for both federal regulatory and financial accounting purposes; (2) submission of information concerning their depreciation accounts when significant changes to depreciation factors are made; and (3) use of a straight-line amortization over a five-year period to account for the difference between the reserve balances on their regulatory books and

[3] Notice, para. 4 (footnotes deleted, emphasis added).

[4] See March 3, 2000 *ex parte* letter to Mr. Lawrence Strickling, Chief, Common Carrier Bureau from Frank J. Gumper, Bell Atlantic Network Services, Robert Blau, BellSouth Corporation, Donald E. Cain, SBC Telecommunications, Inc. and Alan F. Ciamporcero, GTE Service Corporation ("ILEC participants") in CC Docket No. 96-262 – Access Charge Reform; CC Docket No. 94-1 – Price Cap Performance Review for Local Exchange Carriers; CC Docket No. 99-249 – Low-Volume Long Distance Users; and CC Docket No. 96-45 – Federal-State Joint board on Universal Service *("March 3, 2000 letter")*.

> the corresponding balances on their financial books. The ILECs indicated that, under their proposal, the amortization expense for each year would be included in the calculation of regulated earnings (treated as an above-the-line expense) when reporting to the Commission. The ILECs would agree, however, that the amortization would have no effect on interstate price caps or their interstate rates and would commit not to seek recovery of the amortization expense through a low-end adjustment, an exogenous adjustment, or an above-cap filing. Also, under this proposal, the ILECs would commit not to seek recovery of the interstate amortization expense through any action at the state level, including any action on UNE rates.[5]

In these Comments, GSA will address the ILECs' alternative proposal and related issues raised by the Commission in the Notice.

II. ILEC RATE OF RETURN REPORTS SHOULD EXCLUDE PROPOSED AMORTIZATION EXPENSE

In the early 1990s, the ILECs adopted depreciation lives for financial reporting purposes which were much shorter than the lives prescribed by the Commission for regulatory purposes. Pursuant to Generally Accepted Accounting Principles ("GAAP"), this change precipitated significant writedowns of the carrying value of depreciable plant. These writedowns increased the depreciation reserves reported for financial purposes, creating a disparity between the depreciation reserves shown on the regulatory and

[5] Id., para. 10 (footnotes deleted, emphasis added).

financial books.[6] The composite depreciation rates used by the ILECs on their financial books, however, appear to be similar to those prescribed by the Commission.

The net effect on an ILEC's reported rate of return of the waiver requirements as specified in the Depreciation Order would depend upon the change from prescribed to financial book depreciation rates for each carrier. The reduction in rate base due to the writedown would increase the ILEC's reported rate of return, but this increase might be offset by increased accruals resulting from higher financial book depreciation rates.

Under the ILECs' proposal, however, an ILEC's reported rate of return would clearly be lower for the next five years due to the amortization of the reserve difference between the regulated and financial books. This lower rate of return would, in fact, be similar to the rate of return which would result from the use of the much shorter depreciation lives which the Commission has repeatedly, and very recently, rejected.[7]

The rates of return earned by the price cap ILECs are an important indicator of the adequacy of the Commission's price cap plan. As GSA has often noted in the past, the fact that virtually all the price cap ILECs have rates of return every year which far exceed their cost of capital is an indicator that the plan has not been working properly and that interstate access rates have not been just and reasonable.[8] The recently filed 1999 rate

[6] The Commission estimates that the financial books of the ILECs show depreciation reserves which are $28 billion greater than the regulatory books. (Notice, para. 15).

[7] See Depreciation Order, para. 13-19.

[8] See, e.g., Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Comments of GSA, January 7, 2000.

of return reports for Regional Bell Operating Companies ("RBOCs") show the following returns:[9]

Bell Atlantic	13.64
BellSouth	21.05
SBC	18.76
U S WEST	19.09

Ameritech's rate of return of 28.93% was <u>three times</u> its 1999 cost of capital.[10]

These achieved rates of return should sound a loud wake-up call. The use of depreciation amortizations would lower these returns, but would not serve the public interest.

If the Commission approves an amortization of the reserve differences between the regulatory and financial reports for <u>bookkeeping</u> purposes, GSA strongly urges the Commission to record these amounts below-the-line for <u>rate of return</u> reporting purposes.[11]

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[9] 1999 FCC 492A Reports. SBC rate of return shown is weighted average of Ameritech, Southwestern Bell, Pacific Bell, Nevada Bell and the Southern New England Telephone Company.

[10] GSA calculated the weighted average cost of capital of the RBOCs as 9.27 percent in January, 1999. See Unitary Rate of Return of Interstate Services of Local Exchange Carriers, CC Docket No. 98-166, Direct Case of GSA, January 19, 1999.

[11] As a practical matter, the Commission's ARMIS reports would reflect these amortizations, but the Commission's Rate of Return Monitoring Reports (FCC 492A) would not.

If these amortization expenses are excluded from the rate of return reports, of course, there seems little purpose to them at all. GSA recommends, therefore, that this aspect of the Commission's rules not be revised, and that the writedowns be recorded in a single year. This would be consistent with GAAP and the treatment afforded these writedowns on ILEC financial reports.

III. THE COMMISSION SHOULD ESTABLISH SPECIFIC REQUIREMENTS FOR THE PERIODIC COLLECTION OF INFORMATION CONCERNING ILEC DEPRECIABLE ACCOUNTS

The Commission specified the submission of information concerning each ILEC's depreciable plant accounts as a waiver condition in order to enable it to continue to establish ranges for use in cost models.[12] GSA strongly supports this approach.

For over 50 years the Commission reviewed full depreciation studies by every large carrier on a triennal basis. These studies included historical data by depreciable account (e.g. aerial cable metallic, aerial cable non-metallic) and, since at least 1980, information concerning company plans and technological developments. This information has enabled the Commission to prescribe forward-looking lives and establish

[12] Notice, para. 8. The Commission prescribes forward-looking ranges for projection lives and future net salvage percents.

forward-looking ranges for most accounts.

In recent years, the Commission has permitted the ILECs to forgo this triennal review if they did not seek represcription. As a result, the number of represcription reviews has decreased greatly each year.

It is critical that the Commission remain well-informed concerning (1) the past plant activity of the ILECs (adds, retirements, balances) by depreciable category and (2) the future plans of the ILECs. Plant lives and future net salvage percents are critical inputs to all cost models, and the Commission must have timely information to maintain realistic ranges of these parameters. As the Commission notes, these ranges can be relied upon by federal and state regulatory commissions for determining the appropriate depreciation factors to use in establishing high cost support, interconnection and unbundled network element prices.[13]

The ILECs' alternative waiver procedure would limit their submission of information to occasions "when significant changes to depreciation factors are made." The flow of information to the Commission would thus be irregular and totally under the control of the ILECs. Such a procedure would not be in the public interest.

GSA recommends that the Commission revise the ARMIS system to collect historical plant and reserve data by depreciable account (e.g. – metallic vs. non-metallic cable) on an annual basis. This data is already available to the ILECs and would cause minimal revisions to ARMIS Report 43-02 Tables B-1 and B-5.

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[13] Id.

Forecasts of additions and retirements for major network accounts, replacement plans for digital central offices and other forward-looking information should be collected from each ILEC on a biennal, rather that triennal basis, given the pace of technological change. The ILECs should be encouraged to communicate significant changes in their plans at any time, of course. All forecasts and future plans would be granted appropriate confidential treatment.

GSA's recommendations would provide the Commission with the information necessary to maintain its forward-looking depreciation parameter ranges on a timely basis.

IV. THE CPR AUDIT PROCEEDING SHOULD NOT BE TERMINATED

The Commission notes that audits of the continuing property records ("CPR") of the RBOCs and GTE are before the Commission.[14] The CPR audits found that, combined, these carriers could not account for approximately $5 billion of central office equipment and recommended that these amounts be written-off their regulatory books of account.[15] The Commission seeks comments on whether an accounting treatment that results in a non-recoverable amortization of a substantial portion of a carrier's investment provides a legitimate basis to terminate the CPR audits.

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[14] Id., para. 15.

[15] Id.

The writedown of the carrying value of ILEC plant, whether immediate or by amortization, does not make the CPR audit matter moot. First of all, the central finding of the CPR audits was that hard-wired central office equipment ("COE") gross plant investment was over-stated on the regulatory books of the ILECs.[16] The gross plant investment is the same on the financial books as on the regulatory books, unlike the depreciation reserve situation described above. The audits indicate, therefore, that the ILEC financial book gross plant investment is also over-stated. A depreciation rate applied to over-stated plant balances results in over-stated depreciation expense.

Secondly, audits were only performed on what should be the easiest plant to keep track of: hard-wired central office equipment. Such equipment only represents about a quarter of ILEC gross plant investment. The overstatement of portable plug-ins and outside plant facilities may be even greater.

Finally, the audit report recommendations were not limited to the write-off matter. The audit reports also recommended:

1. that the ILECs engage independent auditors to evaluate the practices, procedures and controls the ILECs have in place to maintain their CPRs, and

2. that the ILECs engage independent firms to conduct complete inventories of their CPRs for COE.

None of these matters should be "swept under the rug." The Commission should proceed with its CPR audit proceeding regardless of the outcome of the instant

16 Id

proceeding.

V. CONCLUSION

As a major user of telecommunications services, GSA urges the Commission to implement the recommendations set forth in these Comments.

Respectfully submitted,

GEORGE N. BARCLAY
Associate General Counsel
Personal Property Division

Michael J. Ettner

MICHAEL J. ETTNER
Senior Assistant General Counsel
Personal Property Division

GENERAL SERVICES ADMINISTRATION
1800 F Street, N.W., Rm. 4002
Washington, D.C. 20405
(202) 501–1156

April 17, 2000

CERTIFICATE OF SERVICE

I, CHERYL D. McCLAIN, do hereby certify that copies of the foregoing "Comments of the General Services Administration" were served this 17th day of April, 2000, by hand delivery or postage paid to the following parties.

The Honorable William E. Kennard,
Chairman
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

The Honorable Harold Furchtgott-Roth,
Commissioner
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

The Honorable Susan Ness,
Commissioner
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

The Honorable Gloria Tristani
Commissioner
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C 20554

The Honorable Michael K. Powell
Commissioner
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C 20554

Mr. Kenneth P. Moran
Chief, Accounting Safeguards Division
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street, S.W. Counter TWA325
Washington, D.C. 20554

Ms. Fatina K. Franklin
Chief, Competitive Pricing Division
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Ms. Debbie Byrd
Accounting Safeguards Division
Common Carrier Bureau
Federal Communications Commission
445 12th Street, S.W
Washington, DC 20554

Editorial Offices
Telecommunications Reports
Communications Daily
1333 H Street, N.W., Room 100-E
Washington, D.C. 20005

Ms. Edith Herman
Senior Editor
Communications Daily
2115 Ward Court, N.W.
Washington, D.C. 20037

International Transcription Service
1231 20th Street, N.W.
Washington, D.C. 20554